Financial Accounting Standards Board

ORIGINAL PRONOUNCEMENTS

AS AMENDED

Statement of Financial Accounting Concepts No. 2

Qualitative Characteristics of Accounting Information

PLAINTIFF'S EXHIBIT 4

Statement of Financial Accounting Concepts No. 2
Qualitative Characteristics of Accounting Information

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SUMMARY OF PRINCIPAL CONCLUSIONS

The purpose of this Statement is to examine the characteristics that make accounting information useful. Those who prepare, audit, and use financial reports, as well as the Financial Accounting Standards Board, must often select or evaluate accounting alternatives. The characteristics or qualities of information discussed in this Statement are the ingredients that make information useful and are the qualities to be sought when accounting choices are made.

All financial reporting is concerned in varying degrees with decision making (though decision makers also use information obtained from other sources). The need for information on which to base investment, credit, and similar decisions underlies the objectives of financial reporting. The usefulness of information must be evaluated in relation to the purposes to be served, and the objectives of financial reporting are focused on the use of accounting information in decision making.

The central role assigned to decision making leads straight to the overriding criterion by which all accounting choices must be judged. The better choice is the one that, subject to considerations of cost, produces from among the available alternatives information that is most useful for decision making.

Even objectives that are oriented more towards stewardship are concerned with decisions. Stewardship deals with the efficiency, effectiveness, and integrity of the steward. To say that stewardship reporting is an aspect of accounting's decision making role is simply to say that its purpose is to guide actions that may need to be taken in relation to the steward or in relation to the activity that is being monitored.

A Hierarchy of Accounting Qualities

The characteristics of information that make it a desirable commodity can be viewed as a hierarchy of qualities, with usefulness for decision making of most importance. Without usefulness, there would be no benefits from information to set against its costs.

User-Specific Factors

In the last analysis, each decision maker judges what accounting information is useful, and that judgment is influenced by factors such as the decisions to be made, the methods of decision making to be used, the information already possessed or obtainable from other sources, and the decision maker's capacity (alone or with professional help) to process the information. The optimal information for one user will not be optimal for another. Consequently, the Board, which must try to cater to many different users while considering the burdens placed on those who have to provide information, constantly treads a fine line between requiring disclosure of too much or too little information.

The hierarchy separates user-specific qualities, for example, understandability, from qualities inherent in information. Information cannot be useful to decision makers who cannot understand it, even though it may otherwise be relevant to a decision and be reliable. However, understandability of information is related to the characteristics of the decision maker as well as the characteristics of the information itself and, therefore, understandability cannot be evaluated in overall terms but must be judged in relation to a specific class of decision makers.

Primary Decision-Specific Qualities

Relevance and *reliability* are the two primary qualities that make accounting information useful for decision making. Subject to constraints imposed by cost and materiality, increased relevance and increased reliability are the characteristics that make information a more desirable commodity—that is, one useful in making decisions. If either of those qualities is completely missing, the information will not be useful. Though, ideally, the choice of an accounting alternative should produce information that is both more reliable and more relevant, it may be necessary to sacrifice some of one quality for a gain in another.

To be relevant, information must be timely and it must have predictive value *or* feedback value or both. To be reliable, information must have representational faithfulness and it must be verifiable and neutral. Comparability, which includes consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of information. Two constraints are included in the hierarchy, both primarily quantitative in character. Information can be useful and yet be too costly to justify providing it. To be useful *and* worth providing, the benefits of information should exceed its cost. All of the qualities of information shown are subject to a materiality threshold, and that is also shown as a constraint.

Relevance

- Relevant accounting information is capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations. Information can make a difference to decisions by improving decision makers' capacities to predict or by providing feedback on earlier expectations. Usually, information does both at once, because knowledge about the outcomes of actions already taken will generally improve decision makers' abilities to predict the results of similar future actions. Without a knowledge of the past, the basis for a prediction will usually be lacking. Without an interest in the future, knowledge of the past is sterile.
- Timeliness, that is, having information available to decision makers before it loses its capacity to influence decisions, is an ancillary aspect of relevance. If information is not available when it is needed or becomes available so long after the reported events that it has no value for future action, it lacks relevance and is of little or no use. Timeliness alone cannot make information relevant, but a lack of timeliness can rob information of relevance it might otherwise have had.

Reliability

- The reliability of a measure rests on the faithfulness with which it represents what it purports to represent, coupled with an assurance for the user that it has that representational quality. To be useful, information must be reliable as well as relevant. Degrees of reliability must be recognized. It is hardly ever a question of black or white, but rather of more reliability or less. Reliability rests upon the extent to which the accounting description or measurement is verifiable and representationally faithful. Neutrality of information also interacts with those two components of reliability to affect the usefulness of the information.
- Verifiability is a quality that may be demonstrated by securing a high degree of consensus among independent measurers using the same measurement methods. Representational faithfulness, on the other hand, refers to the correspondence or agreement between the accounting numbers and the resources or events those numbers purport to represent. A high degree of correspondence, however, does not guarantee that an accounting measurement will be relevant to the user's needs if the resources or events represented by the measurement are inappropriate to the purpose at hand.
- Neutrality means that, in formulating or implementing standards, the primary concern should be the relevance and reliability of the information that results, not the effect that the new rule may have on a particular

interest. A neutral choice between accounting alternatives is free from bias towards a predetermined result. The objectives of financial reporting serve many different information users who have diverse interests, and no one predetermined result is likely to suit all interests.

Comparability and Consistency

- Information about a particular enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time. Comparability between enterprises and consistency in the application of methods over time increases the informational value of comparisons of relative economic opportunities or performance. The significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark.

Materiality

- Materiality is a pervasive concept that relates to the qualitative characteristics, especially relevance and reliability. Materiality and relevance are both defined in terms of what influences or makes a difference to a decision maker, but the two terms can be distinguished. A decision not to disclose certain information may be made, say, because investors have no need for that kind of information (it is not relevant) or because the amounts involved are too small to make a difference (they are not material). Magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment. The Board's present position is that no general standards of materiality can be formulated to take into account all the considerations that enter into an experienced human judgment. Quantitative materiality criteria may be given by the Board in specific standards in the future, as in the past, as appropriate.

Costs and Benefits

- Each user of accounting information will uniquely perceive the relative value to be attached to each quality of that information. Ultimately, a standard-setting body has to do its best to meet the needs of society as a whole when it promulgates a standard that sacrifices one of those qualities for another; and it must also be aware constantly of the calculus of costs and benefits. In order to justify requiring a particular disclosure, the perceived benefits to be derived from that disclosure must exceed the perceived costs associated with it. However, to say anything precise about their incidence is difficult. There are costs of using information as well as of providing it; and the benefits from providing financial information accrue to preparers as well as users of that information.
- Though it is unlikely that significantly improved means of measuring benefits will become available in the foreseeable future, it seems possible that better ways of quantifying the incremental costs of regulations of all kinds may gradually be developed, and the Board will watch any such developments carefully to see whether they can be applied to financial accounting standards. The Board cannot cease to be concerned about the cost-effectiveness of its standards. To do so would be a dereliction of its duty and a disservice to its constituents.

Statement of Financial Accounting Concepts No. 2
Qualitative Characteristics of Accounting Information

STATEMENTS OF FINANCIAL ACCOUNTING CONCEPTS

This Statement of Financial Accounting Concepts is one of a series of publications in the Board's conceptual framework for financial accounting and reporting. Statements in the series are intended to set forth objectives and fundamentals that will be the basis for development of financial accounting and reporting standards. The objectives identify the goals and purposes of financial reporting. The fundamentals are the underlying concepts of financial accounting—concepts that guide the selection of transactions, events, and circumstances to be accounted for, their recognition and measurement, and the means of summarizing and communicating them to interested parties. Concepts of that type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting, and applying accounting and reporting standards.

The conceptual framework is a coherent system of interrelated objectives and fundamentals that is expected to lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and reporting. It is expected to serve the public interest by providing structure and direction to financial accounting and reporting to facilitate the provision of evenhanded financial and related information that is useful in assisting capital and other markets to function efficiently in allocating scarce resources in the economy.

Establishment of objectives and identification of fundamental concepts will not directly solve financial accounting and reporting problems. Rather, objectives give direction, and concepts are tools for solving problems.

The Board itself is likely to be the most direct beneficiary of the guidance provided by the Statements in this series. They will guide the Board in developing accounting and reporting standards by providing the Board with a common foundation and basic reasoning on which to consider merits of alternatives.

However, knowledge of the objectives and concepts the Board will use in developing standards should also enable those who are affected by or interested in financial accounting standards to understand better the purposes, content, and characteristics of information provided by financial accounting and reporting. That knowledge is expected to enhance the usefulness of, and confidence in, financial accounting and reporting. Careful use of the concepts may also provide guidance in resolving new or emerging problems of financial accounting and reporting in the absence of applicable authoritative pronouncements.

Statements of Financial Accounting Concepts do not establish standards prescribing accounting procedures or disclosure practices for particular items or events, which are issued by the Board as Statements of Financial Accounting Standards. Rather, Statements in this series describe concepts and relations that will underlie future financial accounting standards and practices and in due course serve as a basis for evaluating existing standards and practices.*

The Board recognizes that in certain respects current generally accepted accounting principles may be inconsistent with those that may derive from the objectives and concepts set forth in Statements in this series. However, a Statement of Financial Accounting Concepts does not (a) require a change in existing generally accepted accounting principles, (b) amend, modify, or interpret Statements of Financial Accounting Standards, Interpretations of the FASB, Opinions of the Accounting Principles Board, or Bulletins of the Committee on Accounting Procedure that are in effect, or (c) justify either changing existing generally accepted accounting and reporting practices or interpreting the pronouncements listed in item (b) based on personal interpretations of the objectives and concepts in the Statements of Financial Accounting Concepts.

Since a Statement of Financial Accounting Concepts does not establish generally accepted accounting principles or standards for the disclosure of financial information outside of financial statements in published financial reports, it is not intended to invoke application of Rule 203 or 204 of the Rules of Conduct of the Code of Professional Ethics of the American Institute of Certified Public Accountants (or successor rules or arrangements of similar scope and intent).†

* Pronouncements such as APB Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*, and the Accounting Terminology Bulletins will continue to serve their intended purpose—they describe objectives and concepts underlying standards and practices existing at the time of their issuance.

†Rule 203 prohibits a member of the American Institute of Certified Public Accountants from expressing an opinion that financial statements conform with generally accepted accounting principles if those statements contain a material departure from an accounting principle promulgated by the Financial Accounting Standards Board, unless the member can demonstrate that because of unusual circumstances the financial statements otherwise would have been misleading. Rule 204 requires members of the Institute to justify departures from standards promulgated by the Financial Accounting Standards Board for the disclosure of information outside of financial statements in published financial reports.

Like other pronouncements of the Board, a Statement of Financial Accounting Concepts may be amended, superseded, or withdrawn by appropriate action under the Board's *Rules of Procedure.*

FASB PUBLICATIONS ON CONCEPTUAL FRAMEWORK

Statements of Financial Accounting Concepts

No. 1, *Objectives of Financial Reporting by Business Enterprises* (November 1978)

Exposure Drafts Being (or Yet to Be) Considered by the Board

Elements of Financial Statements of Business Enterprises (December 28, 1979)

Objectives of Financial Reporting by Nonbusiness Organizations (March 14, 1980)

Discussion Memorandums and Invitations to Comment Having Issues Being Considered by the Board

Reporting Earnings (July 31, 1979)

Financial Statements and Other Means of Financial Reporting (May 12, 1980)

Other Projects in Process

Accounting Recognition Criteria

Funds Flows and Liquidity

CONTENTS

GLOSSARY OF TERMS

Bias

Bias in measurement is the tendency of a measure to fall more often on one side than the other of what is represents instead of being equally likely to fall on either side. Bias in accounting measures means a tendency to be consistently too high or too low.

Comparability

The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena.

Completeness

The inclusion in reported information of everything material that is necessary for faithful representation of the relevant phenomena.

Conservatism

A prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered.

Consistency

Conformity from period to period with unchanging policies and procedures.

Feedback Value

The quality of information that enables users to confirm or correct prior expectations.

Materiality

The magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

Neutrality

Absence in reported information of bias intended to attain a predetermined result or to induce a particular mode of behavior.

Predictive Value

The quality of information that helps users to increase the likelihood of correctly forecasting the outcome of past or present events.

Relevance

The capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations.

Reliability

The quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to represent.

Representational Faithfulness

Correspondence or agreement between a measure or description and the phenomenon that it purports to represent (sometimes called validity).

Timeliness

Having information available to a decision maker before it loses its capacity to influence decisions.

Understandability

The quality of information that enables users to perceive its significance.

Verifiability

The ability through consensus among measurers to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias.

INTRODUCTION

1. The purpose of this Statement is to examine the characteristics of accounting information[1] that make that information useful. This Statement is one of a planned series of publications in the Board's conceptual framework project. It should be seen as a bridge between FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises,* and other Statements to be issued covering the elements of financial statements and their recognition, measurement, and display. The Statement on objectives was concerned with the *purposes* of financial reporting. Later Statements will be concerned with questions about *how* those purposes are to be attained; and the standards that the Board has issued and will issue from time to time are also intended to

[1] "Accounting information," "information provided by financial reporting," and variations on those descriptions are used interchangeably in this Statement.

attain those purposes. The Board believes that, in between the "why" of objectives and the "how" of other Statements and standards, it is helpful to share with its constituents its thinking about the characteristics that the information called for in its standards should have. It is those characteristics that distinguish more useful accounting information from less useful information.

2. Although those characteristics are expected to be stable, they are not immutable. They are affected by the economic, legal, political, and social environment in which financial reporting takes place and they may also change as new insights and new research results are obtained. Indeed, they ought to change if new knowledge shows present judgments to be outdated. If and when that happens, revised concepts Statements will need to be issued.

3. Although conventionally referred to as qualitative characteristics, some of the more important of the characteristics of accounting information that make it useful, or whose absence limit its usefulness, turn out on closer inspection to be quantitative in nature (for example, costliness) or to be partly qualitative and partly quantitative (for example, reliability and timeliness). While it will sometimes be important to keep those distinctions in mind, it will usually be convenient, and not misleading, to refer to all of the characteristics of information discussed in this Statement as "qualities" of information.

4. The qualities of information discussed in this Statement apply to financial information reported by business enterprises and by not-for-profit organizations. Although the discussion and the examples in this Statement are expressed in terms commonly related to business enterprises, they generally apply to not-for-profit organizations as well. "Objectives of financial reporting by business enterprises," "investors and creditors," "investment and credit decisions," and similar terms are intended to encompass their counterparts for not-for-profit organizations, "objectives of financial reporting by not-for-profit organizations," "resource providers," "resource allocation decisions," and similar terms. [2]

5. To maximize the usefulness of accounting information, subject to considerations of the cost of providing it, entails choices between alternative accounting methods. Those choices will be made more wisely if the ingredients that contribute to "usefulness" are better understood. The characteristics or qualities of information discussed in this Statement are, indeed, the ingredients that make information useful. They are, therefore, the qualities to be sought when accounting choices are made. They are as near as one can come to a set of criteria for making those choices.

The Nature of Accounting Choices

6. Accounting choices are made at two levels at least. At one level they are made by the Board or other agencies that have the power to require business enterprises to report in some particular way or, if exercised negatively, to prohibit a method that those agencies consider undesirable. An example of such a choice, made many years ago but still accepted as authoritative, is the pronouncement by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants that "... the exclusion of all overheads from inventory costs does not constitute an accepted accounting procedure"[3] for general purpose external financial reporting.

7. Accounting choices are also made at the level of the individual enterprise. As more accounting standards are issued, the scope for individual choice inevitably becomes circumscribed. But there are now and will always be many accounting decisions to be made by reporting enterprises involving a choice between alternatives for which no standard has been promulgated or a choice between ways of implementing a standard.

8. Those who are unfamiliar with the nature of accounting are often surprised at the large number of choices that accountants are required to make. Yet choices arise at every turn. Decisions must first be made about the nature and definition of assets and liabilities, revenues and expenses, and the criteria by which they are to be recognized. Then a choice must be made of the attribute of assets to be measured—historical cost, current cost, current exit value, net realizable value, or present value of expected cash flows. If costs have to be allocated, either among time periods (for example, to compute depreciation) or among service beneficiaries (for example, industry segments), methods of allocation must be chosen.

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[2]This paragraph is as amended by FASB Concepts Statement No. 6, *Elements of Financial Statements* (December 1985).

[3]Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 4, par. 5.

Further, choices must be made concerning the level of aggregation or disaggregation of the information to be disclosed in financial reports. Should a particular subsidiary company be consolidated or should its financial statements be presented separately? How many reportable segments should a company recognize? Choices involving aggregation arise at every point. Still other choices concern the selection of the terminal date of an enterprise's financial year, the form of descriptive captions to be used in its financial statements, the selection of matters to be commented on in notes or in supplementary information, and the wording to be used.

9. That list of choices, which is by no means comprehensive, illustrates some of the more important choices that arise in financial reporting. References throughout this Statement to alternative accounting policies, methods, or choices refer to the kinds of alternatives illustrated above.

10. If alternative accounting methods could be given points for each ingredient of usefulness in a particular situation, it would be an easy matter to add up each method's points and select the one (subject to its cost) that scored highest—so long, of course, as there were general agreement on the scoring system and how points were to be awarded. There are some who seem to harbor the hope that somewhere waiting to be discovered there is a comprehensive scoring system that can provide the universal criterion for making accounting choices. Unfortunately, neither the Board nor anyone else has such a system at the present time, and there is little probability that one will be forthcoming in the foreseeable future. Consequently, those who must choose among alternatives are forced to fall back on human judgment to evaluate the relative merits of competing methods. If it were not so, there would be no need for a standard-setting authority; for by means of the comprehensive scoring system, agreement on the "best" methods would easily be secured.

11. That does not mean that nothing can be done to aid human judgment. By identifying and defining the qualities that make accounting information useful, this Statement develops a number of generalizations or guidelines for making accounting choices that are intended to be useful to the Board, to its staff, to preparers of financial statements, and to all others interested in financial reporting. For the Board and its staff, the qualities of useful accounting information should provide guidance in developing accounting standards that will be consistent with the objectives of financial reporting. This Statement also provides a terminology that should promote consistency in standard setting. For preparers of financial information, the qualities of useful accounting information should provide guidance in choosing between alternative ways of representing economic events, especially in dealing with situations not yet clearly covered by standards. This Statement also should be useful to those who use information provided by financial reporting. For them, its main value will be in increasing their understanding of both the usefulness and the limitations of the financial information that is provided by business enterprises and other organizations, either directly by financial reporting or indirectly through the commentaries of financial analysts and others. That increased understanding should be conducive to better-informed decisions.

12. The need for improved communication, especially between the Board and its constituents, provides much of the rationale for the whole conceptual framework project and particularly for this Statement. Indeed, improved communication may be the principal benefit to be gained from it. It is important that the concepts used by the Board in reaching its conclusions be understood by those who must apply its standards and those who use the results, for without understanding, standards become mere arbitrary edicts. Communication will also be facilitated if there is widespread use of a common terminology and a common set of definitions. The terminology used in this Statement is already widely, though not universally, used and its general adoption could help to eliminate many misunderstandings. The definitions of the principal terms used have been brought together in the glossary on page CON2–6.

13. It should perhaps be emphasized here that this Statement is not a standard. Its purpose is not to make rules but to provide part of the conceptual base on which rule making can stand. Unless that distinction is understood, this Statement may be invested with more authority than a discussion of concepts has a right to carry.

14. Whether at the level of the Board or the individual preparer, the primary criterion of choice between two alternative accounting methods involves asking which method produces the better—that is, the more useful—information. If that question can be answered with reasonable assurance, it is then necessary to ask whether the value of the better information sufficiently exceeds that of the inferior information to justify its extra cost, if any. If a satisfactory

answer can again be given, the choice between the alternative methods is clear.

15. The qualities that distinguish "better" (more useful) information from "inferior" (less useful) information are primarily the qualities of relevance and reliability, with some other characteristics that those qualities imply. Subject to considerations of cost, the objective of accounting policy decisions is to produce accounting information that is relevant to the purposes to be served and is reliable. The meaning of those terms, the recognition that there are gradations of relevance and reliability, and the problems that arise if trade-offs between them are necessary all are matters discussed in later paragraphs of this Statement.

16. Accounting choices made by the Board and those made by individual statement preparers have this in common: they both aim to produce information that satisfies those criteria. Yet, though the objectives of the Board and of individual preparers are alike in that respect, the Board does not expect all its policy decisions to accord exactly with the preferences of every one of its constituents. Indeed, they clearly cannot do so, for the preferences of its constituents do not accord with each other. Left to themselves, business enterprises, even in the same industry, would probably choose to adopt different reporting methods for similar circumstances. But in return for the sacrifice of some of that freedom, there is a gain from the greater comparability and consistency that adherence to externally imposed standards brings with it. There also is a gain in credibility. The public is naturally skeptical about the reliability of financial reporting if two enterprises account differently for the same economic phenomena.

17. Throughout this Statement, readers should keep in mind the objectives of the Board in issuing accounting standards of widespread applicability and those of individual preparers who are concerned with the informational needs of a particular enterprise. Though the criteria by which information should be judged are the same whether the judgment is made by the Board or by a preparer, they cannot be expected always to produce agreement on a preferred choice of accounting method. The best accounting policies will provide information that best achieves the objectives of financial reporting. But whatever information is provided, it cannot be expected to be equally useful to all preparers and users, for the simple reason that individual needs and objectives vary. The Board strives to serve the needs of all, knowing that in doing so some individual preferences are sacrificed. Like motorists who observe traffic laws in the interest of their own and general traffic safety, so long as others do the same, in general, those who have to subordinate their individual preferences to observe common accounting standards will, in the long run, gain more than they lose.

18. The analogy between accounting standards and traffic laws merits closer examination. Traffic laws impose certain minima or maxima in regulating behavior but still permit considerable flexibility in driving habits. A speed limit leaves slow drivers to choose their speed below the maximum and does not prohibit passing by other drivers. Even a requirement to drive on the right allows a driver to choose and to change lanes on all but very narrow roads. The point is that in most respects the traffic laws allow for considerable variations within a framework of rules. In setting accounting standards, the Board also strives to leave as much room as possible for individual choices and preferences while securing the degree of conformity necessary to attain its objectives.

19. This Statement must be seen as part of the larger conceptual framework, an important part of the foundations of which were laid with the publication of Concepts Statement 1. This Statement, with the proposed Statement on the elements of financial statements of business enterprises, is part of the second stage of the structure. With successive stages, the level of abstraction will give way to increasing specificity. The qualitative characteristics discussed in this document are formulated in rather general terms. As they are brought to bear on particular situations in subsequent pronouncements, however, those generalizations will give way to specific applications.

20. While this Statement concentrates on guidelines for making accounting choices, either by the Board or by those who provide financial information, its function is not to make those choices. Insofar as those choices lie within the Board's responsibility, some of them (for example, those relating to the attributes of assets and liabilities that should be measured and presented in financial statements) will be made in other parts of the conceptual framework project. Other choices will be made in the standards to be issued by the Board from time to time. The qualitative characteristics put forward in this Statement are intended to facilitate those choices and to aid in making them consistent with one another.

The Objectives of Financial Reporting

21. The objectives of financial reporting underlie judgments about the qualities of financial information, for only when those objectives have been established can a start be made on defining the characteristics of the information needed to attain them. In Concepts Statement 1, the Board set out the objectives of financial reporting for business enterprises that will guide it. The information covered by that Statement was not limited to the contents of financial statements. "Financial reporting," the Statement said, "includes not only financial statements but also other means of communicating information that relates, directly or indirectly, to the information provided by the accounting system—that is, information about an enterprise's resources, obligations, earnings, etc. [paragraph 7]."

22. The objectives of financial reporting are summarized in the following excerpts from the Statement:

> Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence. [paragraph 34]
>
> Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. The prospects for those cash receipts are affected by an enterprise's ability to generate enough cash to meet its obligations when due and its other cash operating needs, to reinvest in operations, and to pay cash dividends and may also be affected by perceptions of investors and creditors generally about that ability, which affect market prices of the enterprise's securities. Thus, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise. [paragraph 37]
>
> Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change resources and claims to those resources. [paragraph 40]
>
> Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance. [paragraph 42]
>
> The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components. [paragraph 43]
>
> Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency. [paragraph 49]
>
> Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it. [paragraph 50]
>
> Financial reporting should provide information that is useful to managers and directors in making decisions in the interests of owners. [paragraph 52]

23. The Statement on objectives makes clear (paragraph 31) that *financial reporting* means *general purpose external financial reporting by business enterprises.* General purpose financial reporting attempts to meet "the informational needs of external users who lack the authority to prescribe the financial information they want from an enterprise and therefore must use the information that management communicates to them" (paragraph 28). General purpose statements are not all purpose statements, and never can be.